DIRECT TESTIMONY

OF

JOY NICDAO-CUYUGAN

SPECIAL ASSISTANT TO THE ACTING MANAGER

TELECOMMUNICATIONS DIVISION

ILLINOIS COMMERCE COMMISSION

AMERITECH ILLINOIS

DOCKET NO. 98-0252/0335 (Consol.)

NOVEMBER 2000

Q. Please state your name and business address.

A. My name is Joy Nicdao-Cuyugan. My business address is 160 North LaSalle, Suite C-800, Chicago, Illinois 60601-3104.

Q. By whom are you employed and in what capacity?

A. I am employed by the Illinois Commerce Commission as the Special Assistant to the Acting Manager of the Telecommunications Division.

Q. Please describe your qualifications and background.

A. In April of 1987, I received a Bachelor of Science degree in Business Management and a Bachelor of Arts degree in Psychology from De La Salle University. In May of 1991, I received a Master of Business Administration degree, with a concentration in Finance, from the University of Illinois at Springfield. I was employed by the Illinois Commerce Commission in July 1991 as a Financial Analyst. I was subsequently promoted to the following positions: Senior Financial Analyst in May 1994; Director of the Finance Department in April 1998; and Special Assistant to the Financial Analysis Division Manager in July 2000. In September 2000, I transferred to the Telecommunications Division as the Special Assistant to the Acting Telecommunications Division Manager. I have previously testified before the Commission on rate of return and other regulatory finance issues.

Q. **What is the purpose of your testimony in this proceeding?**

A. The purpose of my testimony is to respond to the direct testimony of Ameritech Illinois (AI or the Company) witness Dr. William Avera.

Q. **Please summarize the main points of Dr. Avera's direct testimony.**

A. Dr. Avera's testimony describes his opinions of investors' perceptions of Ameritech Illinois. First, he opines that investors view AI's profits under alternative regulation as quite reasonable when "normalized" for the favorable economic environment and the Company's risks.[1] Second, he opines that because the economic environment cannot be better than what it is currently, "the Company must run faster just to maintain its past growth record."[2] Lastly, he asserts that adverse changes to AI's current alternative regulation plan based upon AI's earnings would result in investor reluctance to provide needed capital to AI.[3]

Q. **Do you agree with Mr. Avera that investors view AI's profits under alternative regulation as quite reasonable when "normalized" for the favorable economic environment and the risks that the Company faces?**

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[1] Ameritech Illinois Ex. 8.0, p. 8.
[2] Ibid., p. 25.
[3] Ibid., pp. 26-28.

A. It is unclear what Dr. Avera means by a "quite reasonable" return to investors. Nonetheless, modern financial theory indicates that investors require a return commensurate with the risks of an investment. Therefore, one could reasonably assert that a "reasonable return" to investors is one that equals their required return of a particular investment. Without performing an analysis of investor's requirements of AI in each year since alternative regulation was adopted, Dr. Avera cannot conclusively state that AI's earned returns for that same period were reasonable. Such returns could also have been more than "reasonable" for investors (i.e., excessive) if AI's earned returns were significantly higher than investors' required return.

On the other hand, the higher a firm's earned return is above investors' return requirements, the more "reasonable" that return could be from an investor's point of view. Yet, high earned returns could be indicative of a sub-optimal price structure for the firm's customers. Therefore, even if Dr. Avera could support his assertion that AI's past earned returns were reasonable to investors, it would be of little value to this proceeding since it ignores the perspective of customers.

Finally, it is important to note that if Dr. Avera's assertion is true, then the converse of his assertion would also be true. That is, decreased AI profits due to a future slow down in the economy, would still be viewed as reasonable by investors since they would "normalize" such profits for the less favorable economic environment.

Q. **Please comment on Dr. Avera's claim that since the economic environment**

cannot be better than what it is currently, "the Company must run faster just to maintain its past growth record."

A. Although these comments are interesting, they are irrelevant for the purposes of this proceeding. This proceeding is not about ensuring that AI's shareholders will continue to enjoy AI's past levels of earnings growth. Rather, it is about ensuring that AI's alternative regulation plan meets the goals outlined in Section 13-506.1 of the Public Utilities Act which, if achieved, would benefit both AI customers and shareholders.

Q. **Please comment on Dr. Avera's assertion that adverse changes to the current alternative regulation plan based upon AI's earnings will result in investor reluctance to provide capital to AI.**

A. Staff witnesses Staranczak and Koch's testimonies demonstrate that Staff's proposed changes to the current alternative regulation plan are not primarily based upon AI's past earnings nor are they tied to AI's future earnings.[4] Therefore, even if Dr. Avera's opinion were correct, it would be irrelevant in the context of Staff's proposal for this proceeding.

Nevertheless, financial theory indicates that investors will provide capital to investments they believe will generate returns they require to compensate them for

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[4] ICC Staff Exhibits 2.0 and 13.0.

the risks assumed. Therefore, an increase to AI's risk as a result of changes to the alternative regulatory plan would not necessarily hinder nor remove AI's access to the capital markets.

Q. **Is a firm's access to capital ever affected by its level of risk?**

A. Yes. As a general proposition, less capital is available to firms with very high levels of risk. Such high risk firms generally have non-investment grade credit ratings (e.g., BB+ or lower under Standard & Poor's (S&P) credit rating system and Ba1 or lower under Moody's credit rating system). In contrast, AI's corporate credit rating from S&P and Moody's is AA- and Aa1, respectively. [5] Both high investment grade ratings are reflective of AI's strong financial condition and the relatively low risk investors perceive AI possesses. Consequently, AI has reasonable access to the capital markets.

Q. **Please comment on Dr. Avera's assertion that since investors do not expect a revision to alternative regulation, any such modification would unsettle confidence in Illinois regulation and inject additional uncertainty and risk into AI's future earnings.[6]**

A. Dr. Avera's statement is based upon his review of published analyst comments on

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[5] Standard and Poor's Ratings Direct, www.ratingsdirect.com, May 26, 2000; www.moodys.com, October 19, 2000. Investment grade ratings range from AAA to BBB- under Standard & Poor's credit rating system and Aaa to Baa3 under Moody's credit rating system.
[6] Ameritech Illinois Ex. 8.0, p. 27.

AI that are not necessarily reflective of all investors' expectations of AI nor of their expectations on possible outcomes of the alternative regulatory plan review process. Second, the ICC Order adopting the alternative regulatory plan clearly established annual reporting requirements and a five-year review for the purpose of evaluating the plan's effectiveness.[7] Any regulatory review brings with it the possibility of changes and improvements being adopted. Therefore, it is quite improbable that investors would neither expect nor consider the possibility of <u>any</u> revision to the alternative regulatory plan.

Third, the Commission's judgement should not be wholly based upon whether a particular decision will or will not increase the risk of the regulated utility, particularly when the magnitude of that incremental risk has not been established. Rather, the Commission's decision should turn upon the balancing of shareholders' and ratepayers' interest based upon facts instead of speculation.

Finally, it is important to note that AI is proposing in this proceeding to eliminate the consumer dividend component of its alternative regulation plan. (See Staff Ex. 2.0 for a discussion of the consumer dividend.) Since the consumer dividend is an offset in the price cap plan formula, removal of the consumer dividend would effectively allow AI to impose relatively higher prices for regulated services and, thus, the opportunity to earn higher returns. If Dr. Avera's claim that investors do not expect any revision to the alternative regulation plan is true, then holding all else

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[7] Docket Nos. 92-0448/93-0239 (consol.) Order, Appendix A.

equal, granting AI's proposal to eliminate the consumer dividend would result in a windfall to investors.

Q. **Please summarize your findings and recommendations**.

A. Dr. Avera's opinions of investor perceptions of AIT are largely unfounded and irrelevant. Therefore, the Commission should not allow its decision in this proceeding to be influenced by the claims made in Dr. Avera's testimony.

Q. **Does this question conclude your direct testimony?**

A. Yes, it does.